

Global Project Finance Alert

IRS Clarifies Certain Tax Consequences for the Cash Grant for Renewable Energy Projects

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The U.S. Internal Revenue Service today released Notice 2012-23 (available [here](#)), which clarifies several technical issues relating the interaction of the Internal Revenue Code and the U.S. Department of the Treasury's rules for the cash grant for renewable energy projects under section 1603 of the American Recovery and Reinvestment Tax Act of 2009. Most renewable energy projects will be unaffected by these clarifications. A summary of the points clarified by the IRS is below.

- **Sale-Leaseback More Than Three Months After an Asset is Placed in Service.** The IRS provided detail on a leasing transaction that we have not seen in the market but that could be of interest to developers in limited circumstances. In this transaction, the developer places the asset in service and claims a cash grant based on its tax basis in the asset (*i.e.*, generally, its cost). The cash grant is paid to the developer, who reduces its basis in the asset by one-half of the amount of the cash grant. More than three months after the asset is placed in service, the developer enters into a sale-leaseback and becomes the lessee. In calculating its taxable gain from the sale of the asset to the buyer/lessor, the developer uses its basis (as reduced by one-half of the cash grant). Although the developer is now the lessee, it does not amortize one-half of the cash grant into income (as is the case for a lessee under a pass-through lease) because it already reduced its basis following receipt of the cash grant. Developers may wish to consider this approach if either: (i) they want to execute a sale-leaseback but are unable to close the sale-leaseback within three months of the placed in service date, or (ii) their cost to construct the asset exceeds what a buyer/lessor would pay in a sale-leaseback.
- **Tax-Depreciation Timing To Be Determined on an Asset-by-Asset Basis.** The cash grant rules permit an owner of contiguous renewable energy assets, such as a series of wind turbines, to elect to group those assets together for purposes of determining when: (i) they are "placed in service" (*e.g.*, the first one is not placed in service until the last contiguous one is placed in service), and (ii) physical construction began. The IRS confirmed that the timing of tax depreciation for each asset will be determined individually, despite the election to treat the group as a single asset for purposes of a cash grant.

The IRS also covered two "niche" issues: one of interest to residential developers and investors, and the other of interest to developers with tax-exempt investors.

- **Energy Conservation Subsidies Reduce Cash Grant Eligible Basis.** If the owner of a project receives a subsidy in the form of a payment from a public utility for energy conservation improvements to a home or an apartment building, then that payment is not subject to taxation pursuant to section 136 of the Code. However, the payment nonetheless reduces the tax basis of the energy conservation improvement and, therefore, reduces the eligible basis for a cash grant.



- **Effect of Indirect Tax-Exempt Partner on Depreciation Rate for Assets Held by Renewable Energy Partnership.** If a tax-exempt entity invests in a renewable energy partnership through a taxable corporation, then the partnership is eligible for a cash grant, despite its indirect tax-exempt ownership. However, the partnership's assets may nonetheless be subject to slower depreciation as a result of its having a corporate partner that is owned by a tax-exempt entity, if the partnership's allocations of income and loss are not "straight-up" (in other words, for example, if the partnership's allocations are disproportionate or subject to flips).

Finally, the IRS addressed two issues that were clear before.

- **Effect of Cash Grant on Recipient's Basis or Income.** The IRS confirmed that the tax basis of a cash grant eligible asset is reduced by an amount equal to 50 percent of the amount of the cash grant. If a cash grant is received by a lessee, then the lessee includes an amount equal to 50 percent of the cash grant in income *pro rata* over five years.
- **DOE Loan Guarantees Have No Effect on Recipient's Basis.** The cash grant eligible basis of an asset in a project is not affected by the fact the project received a loan guarantee from the U.S. Department of Energy.

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